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BROKER DEALER

FINRA Requests Comment on Proposed Rule Set for Limited Corporate Financing Brokers

The Financial Industry Regulatory Authority has requested comments on a proposed rule set for limited corporate financing brokers (LCFBs). LCFBs are firms that engage in certain limited activities, such as advising companies and private equity funds with regard to one or more of the following: raising capital, corporate restructuring, selecting an investment banker, preparing offering materials, fairness opinions and qualifying or soliciting institutional investors. To reflect the limited activities of LCFBs, the proposed rule set is narrower than the rules for traditional broker dealers and applies exclusively to LCFBs. Under FINRA's proposal, LCFBs may not maintain customer accounts, hold customers' securities, accept orders, exercise investment discretion or engage in proprietary trading or market-making activities. FINRA has requested comments on (i) whether the proposed rule set sufficiently protects LCFB customers, (ii) whether additional activities other than those listed above should be permitted and (iii) the economic impact of the proposed rules. The comment period ends on April 28, 2014.

The Proposed Rules are available here.

FINRA's notice to members is available here.

SEC Issues No-Action Relief to Broker Dealers from Financial Responsibility Rule 15c3-3 Amendments

On February 26, the Securities and Exchange Commission's Division of Trading and Markets granted two separate requests for no-action relief, one submitted by the Securities Industry and Financial Markets Association (SIFMA) and the other by the Financial Industry Regulatory Authority. The SEC approved SIFMA's request to obtain verbal consent (with written confirmation within 90 days) from each customer before the customer's free credit balances in a securities account are swept into a money market mutual fund or Federal Deposit Insurance Corporation-insured bank account (sweep programs). In a separate letter, the SEC stated that it would not recommend enforcement action if a broker dealer held cash in a reserve account at a non-affiliated US branch of a foreign bank in making minimum deposit determinations required by SEC Rule 15c3-3.

An amendment to SEC Rule 15c3-3 (specifically paragraph (j)(2)(ii)(A)), which became effective on March 3, requires a broker dealer to obtain written consent from a customer before including the customer's account in sweep programs. SIFMA requested no-action relief because most of its member firms use account-opening technology that makes obtaining written consent costly and unfeasible. Sweep programs typically include funds not invested in higher-yield instruments, and prior written consent could only be obtained by a manual process that would be expensive and burdensome. The SEC imposed four conditions with respect to the requested relief: (1) the broker dealer has obtained affirmative consent after providing notice of the general terms and conditions of the sweep program; (2) the customer specifically has consented to include free credit balances in the sweep program before the account agreement or written consent documentation is executed; (3) the broker dealer documents Items 1 and 2 at the time the account is opened; and (4) the broker dealer establishes a process reasonably designed to obtain written consent within 90 days and must stop including the customer's balances in the sweep program if written consent is not obtained within 90 days. The no-action relief will be effective from March 3, 2014 to March 3, 2015.

Under amended paragraph (e)(5) of SEC Rule 15c3-3, a broker dealer must determine (1) the minimum deposits with an affiliated bank and (2) cash deposits exceeding 15 percent of the bank's equity capital, as reported in the bank's most recent call report. The SEC granted relief allowing a broker dealers to hold cash in a reserve account at a non-affiliated US branch of a foreign bank, provided that the following conditions are satisfied: (1) the foreign bank has a pending exemptive request with the SEC on or before March 3, 2014 with respect to its US branch; and (2) the broker dealer uses the foreign bank's equity capital instead of a call report to calculate the 15 percent bank equity capital threshold, on or after March 3, 2014. Commenters had previously expressed concerns to the SEC that call reports filed by US branches of foreign banks did not have equity capital line items.

Click here to read the SIFMA No-Action Letter and here to read the FINRA No-Action Letter.

CFTC

CFTC Reissues FAQ on Commodity Options

The Commodity Futures Trading Commission's Division of Market Oversight (DMO) has reissued a document addressing frequently asked questions (FAQs) on commodity options. The FAQs document, which DMO originally issued on September 30, 2013, reminds market participants that commodity options are generally regulated as swaps, but that the CFTC has adopted certain exceptions and exemptions for commodity options (including volumetric options) that are embedded in forward contracts and trade options. To qualify as a trade option, a commodity option must (i) involve a physical commodity, (ii) be offered by either an eligible contract participant or a commercial participant, (iii) be offered to a commercial participant and (iv) be intended to be physically settled.

The FAQs document also reminds trade option participants of certain reporting requirements under Parts 32 and 45 of the CFTC's Regulations. For trade options in which neither counterparty is a swap dealer (SD) or major swap participant (MSP), the counterparties may report such trade options through an annual Form TO filing in lieu of reporting such trade options to a swap data repository pursuant to Part 45 of the CFTC's Regulations. If a non-SD/MSP is already reporting other swaps to a swap data repository, then such non-SD/MSP must notify DMO via email no later than 30 days after entering into trade options having an aggregate notional value in excess of $1 billion in any calendar year to qualify for such relief.

DMO's FAQs document is available here.

CFTC to Host Roundtable on End-Users

Commodity Futures Trading Commission staff will host a public roundtable on April 3, 2014 to discuss issues relating to end-users, including (i) end-user recordkeeping obligations for commodity interest and related cash or forward transactions, (ii) forward contracts with embedded volumetric optionality and (iii) the "special entity" *de minimis* threshold for swap transactions with government-owned electric utilities.

More information is available here.

LITIGATION

District Court Grants Preliminary Approval of Settlement in Merger Case

The US District Court for the Western District of Pennsylvania recently granted preliminary approval to settle a merger suit in which Michael Baker Corp. (Baker) shareholders alleged that the $397 million purchase price that Integrated Missions Solutions, Inc. (IMS) paid for Baker was "grossly inadequate."

Baker announced in late July 2013 that it had entered into a definitive merger agreement with IMS (with the per-share purchase price representing not less than a 37 percent premium). The merger was to be accomplished following a cash tender offer by an IMS subsidiary to acquire all of Baker's outstanding shares.

Soon thereafter, plaintiffs sent demand letters to Baker's Board of Directors (Board). Baker established a special litigation committee (SLC) in late August 2013, and filed a Schedule 14D-9 in support of the tender offer in early

September 2013. During its investigation, the SLC shared with plaintiffs over 5,400 pages of non-public, internal information concerning the IMS deal.

After reviewing the materials provided, plaintiffs and their counsel made a written demand for action, met with counsel for Baker's Board and SLC, and ultimately commenced this action on September 24, 2013. Plaintiffs alleged, under federal securities law and Pennsylvania law, that Baker and its directors had breached their fiduciary duties by seeking to sell Baker through an "unfair process, for an inadequate price and on unfair terms, and that [they] failed to provide material information and/or omitted material information from the Schedule 14D-9."

On October 1, 2013, Baker filed additional disclosures in a Supplemental 14D-9, and when the merger closed on October 11, 2013, the parties entered a memorandum of understanding. After reviewing the SLC's report, plaintiffs and counsel determined that no further investigation was necessary, and the parties entered into a stipulation of settlement in late December 2013.

Under the proposed settlement, Baker denies any wrongdoing and acknowledges that plaintiffs' actions caused Baker to release additional disclosures concerning the merger with IMS. Baker will pay up to $365,000 for plaintiffs' attorneys' fees and costs.

Bisch v. Bontempo et al., Case No. 13-cv-1392 (W.D. Pa. Mar. 3, 2014).

US Court of Appeals for the Eleventh Circuit Upholds Fraud Penalties for Ex-GlobeTel Executives

The US Court of Appeals for the Eleventh Circuit recently upheld a summary judgment decision granted in favor of the US Securities and Exchange Commission against three former GlobeTel Communications Corp. (GlobeTel) employees for their participation in a scheme to report over $100 million in fictitious revenue. In addition, the court affirmed an award of $1.9 million in disgorgement and civil penalties entered against the GlobeTel executives.

GlobeTel described itself as being in the wholesale telecom business. In two separate actions, the SEC alleged that GlobeTel's executives created a series of false invoices so that GlobeTel could record revenue for telecom services that actually were provided by other firms.

GlobeTel's Chief Financial Officer, Lawrence Lynch, settled with the SEC on liability but contested the damage amounts. Two other individuals, Chief Operating Officer Joseph Monterosso and his business partner, Luis Vargas, contested both liability and damages.

The US District Court for the Southern District of Florida granted summary judgment in favor of the SEC as against Monterosso and Vargas, finding them jointly and severally liable for $675,000 in disgorgement, while imposing civil penalties of $300,000 and $150,000. With respect to Lynch, the District Court ordered payment of a civil penalty of $780,000.

On appeal, the Eleventh Circuit found that there was ample evidence in the record to support the summary judgment finding and, in particular, rejected the argument that Monterosso and Vargas lacked *scienter* because the scheme had been approved by senior management. The court affirmed the joint and several disgorgement award because (a) the SEC had produced a "reasonable approximation" of the defendants' ill-gotten assets, and (b) there was evidence in the record showing that Monterosso and Vargas had "acted in concert." With respect to the civil penalties, the Eleventh Circuit affirmed because the record showed misconduct involving fraud and deceit, and because the District Court took into account the defendants' ability to pay.

SEC v. Monterosso., et al., No. 0:07-cv-61693-JAL (S.D. Fl. March 3, 2014).

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